UNITED STATES BANKRUPTCY COURT
SOUTHERN DISTRICT OF NEW YORK

In re:

53 STANHOPE LLC, et al.,

Debtors.

Case No.: 19-23013-rdd

Chapter 11
(Jointly Administered)

MODIFIED BENCH RULING ON CONFIRMATION OF THE DEBTOR'S AMENDED JOINT CHAPTER 11 PLAN OF REORGANIZATION

APPEARANCES:

BACKENROTH FRANKEL & KRINSKY, LLP, by Mark Frankel, Esq., for the debtors and debtors in possession

ABRAMS, FENSTERMAN, FENSTERMAN,
EISMAN, FORMATO, FERRARA, WOLF & CARONE, LLP, by Andrea Caruso, Esq., for the debtors and debtors in possession

KASOWITZ BENSON TORRES LLP, by Jennifer Recine, Esq. and Andrew Glenn, Esq., for Brooklyn Lender, LLC

NORRIS MCLAUGHLIN, P.A., by Melissa Pena, Esq., for the Israeli Investors

HON. ROBERT D. DRAIN, United States Bankruptcy Judge

The Court gave a lengthy oral ruling on December 17, 2020 regarding the request of each of the 18 debtors and debtors in possession herein (the "Debtors") for confirmation of their amended joint chapter 11 plan of reorganization [Dkt. 93] (the "Plan") and their related objection to a substantial portion of the proofs of claim filed in each of these cases by their primary secured creditor, Brooklyn Lender, LLC ("Brooklyn Lender"). In requesting confirmation of the Plan, the Debtors

also sought a determination that the claims of the "Israeli Investors" -- which comprise claims filed against the Debtors by (a) what the parties have referred to as the "Israeli Investor LLCs" and (b) individual investors in the Investor LLCs (the "Individual Israeli Investors") -- should be subordinated under section 510(b) of the Bankruptcy Code, 11 U.S.C. § 510(b), to the claims of the Debtors' other creditors (except to the extent that certain of the Debtors' other creditors have agreed to different treatment under the Plan). Class 6 of the Plan provides for such treatment. My bench ruling also addressed that issue, as well as other confirmation issues raised by the Israeli Investors. The Israeli Investors and the Debtors previously agreed, however, not to litigate at this time the merits of the Debtors' objections to the Israeli Investors' claims with the exception of the Plan's right to treat those claims as subject to mandatory subordination under section 510(b) of the Bankruptcy Code. My ruling therefore only addressed the merits of those claims to the extent they were relevant to the feasibility of the Plan under section 1129(a)(11) of the Bankruptcy Code, 11 U.S.C. § 1129(a)(11).

It was important for the parties to receive a ruling promptly, as the Debtors had obtained exit financing for the

Plan that was time sensitive. I informed the parties, though, that I might review the transcript and file a modified bench ruling, which of course would not at that point be a transcript, if the transcript warranted improvement in grammar or clarity for the benefit of the parties and any appellate court. I do so here; my underlying rulings on the Plan and confirmation-related issues, including the Debtors' objections to Brooklyn Lender's claims, have not changed, however.

The foregoing issues were the subject of an evidentiary hearing held in July and August 2020, and this Modified Bench Ruling reflects the Court's assessment of the witnesses' testimony and exhibits admitted into evidence, as well as the parties' post-trial briefing.

The Debtors propose to finance their exit from Chapter 11 with a loan from an entity known as Lightstone Capital. The exit loan proceeds would suffice to pay in full the claims of Brooklyn Lender in the amount that the Debtors contend those claims should be allowed, roughly $35.3 million. Indeed, after paying allowed administrative expenses and general unsecured claims that the Plan also provides will be paid in full on the Plan's effective date -- but not the payment of any cash on account of the Israeli Investors' claims, which the Plan contemplates satisfying, to the extent allowed, with equity interests in the applicable reorganized

Debtors -- the exit loan would leave the reorganized Debtors with approximately a $2 million cushion before consideration of Brooklyn Lender's claim for attorneys fees and expenses under section 506(b) of the Bankruptcy Code, 11 U.S.C. § 506(b). Section 506(b)'s allowance of claims for attorneys fees and costs, as well as for allowance of postpetition interest notwithstanding the general rule, codified in section 502(b)(2) of the Bankruptcy Code, 11 U.S.C. § 502(b), against the allowance of claims for postpetition interest, comes into play because the Debtors acknowledge that in each of their estates Brooklyn Lender is oversecured -- that is, the value of its collateral exceeds the amount of its claim against each Debtor for unpaid principal and prepetition interest. Under section 506(b), Brooklyn Lender would have an entitlement, up to the value of its collateral, not only to the allowance of any unpaid postpetition interest, but also to reasonable attorneys' fees and expenses as provided in the various loan agreements that the Debtors entered into with Brooklyn Lender's assignor and the Debtors' original lender, Signature Bank. Even with the payment of reasonable attorneys fees and expenses, however, the Debtors contend that they would have a small surplus left over, including for interest payments under the Lightstone Capital loan after a lengthy interest payment holiday thereunder, and could service that loan

or reduce it by refinancing or selling various of their properties at agreed-to release prices.

Brooklyn Lender opposes the Debtors' objections to its claims and confirmation of the Plan, as have the Israeli Investors.

The Plan is an unimpairment plan under section 1124(1) of the Bankruptcy Code because it provides for cash payment in full of the allowed claims against each Debtor's estate (except where a claimant has agreed to a lesser treatment). Section 1124(1) provides that a claim is impaired unless the plan "leaves unaltered the legal, equitable, and contractual rights to which such claim or interest entitles the holder of such claim or interest." Section 1126(f) of the Bankruptcy Code, 11 U.S.C. § 1126(f), provides that classes that are not impaired by a chapter 11 plan are deemed to have accepted it.

If, however, any Debtor lacks sufficient cash to pay Brooklyn Lender's ultimately allowed claims against it, the Plan cannot be confirmed with respect to such Debtor because Brooklyn Lender would be impaired and its votes in that Debtor's case would have to be counted, and, therefore, the Debtor would have to "cram down" the Plan over Brooklyn Lender's negative vote under section 1129(b) of the Bankruptcy Code, 11 U.S.C. § 1129(b) --

something that the Debtors have not tried to do -- or the Plan would not be feasible as to such Debtor under section 1129(a)(11) of the Bankruptcy Code, which the Debtors appear to concede.

Even if Brooklyn Lender's allowed claims exceed the amount of cash available only at certain of the Debtors, moreover, the Plan cannot be confirmed, because the Plan is a joint plan for all of the Debtors and does not provide for the Debtors' substantive consolidation. It also is the case that Lightstone Capital's exit financing cannot be disaggregated from all or substantially all of the Debtors.

If the Israeli Investors' allowed claims cannot be subordinated under section 510(b) of the Bankruptcy Code and more cash is required to pay them than is provided for in the exit facility combined with the Debtors' other sources of cash, the Plan also cannot be confirmed unless amended to provide for such claims' impairment and cram down, again something that the Debtors have not sought.

I will first address the issues raised with respect to Brooklyn Lender's claims and then turn to the Israeli Investors.

Although Signature Bank made separate mortgage

loans to each Debtor, the underlying loan documents are basically in the same form. Each Debtor has a substantially similar note and mortgage, which Signature Bank previously assigned to Brooklyn Lender. Thus references to a provision in a loan document can apply to the same provision in each loan document unless otherwise noted.

The fundamental dispute between the Debtors and Brooklyn Lender is over the amount of the interest component of Brooklyn Lender’s claims, both with respect to claims for pre-bankruptcy, or prepetition interest and claims for postpetition, or pendency interest, i.e. interest accruing after the bankruptcy petition date and before confirmation and the effective date of the Plan. The Debtors contend that both pre- and postpetition interest should be allowed on Brooklyn Lender’s claims at the non-default contract rate, which, because they have consistently paid that interest, would mean that any further claims by Brooklyn Lender for unpaid interest would be disallowed. Brooklyn Lender, to the contrary, contends that it has an allowed claim for a substantial amount of unpaid default rate interest, accrued both pre- and postpetition. Brooklyn Lender’s non-default rate varies among the Debtors, between 3.625 percent and 4.35

percent, whereas the default rate under the loan documents is 24 percent. Moreover, Brooklyn Lender has asserted certain defaults against each Debtor that the parties agree -- if default interest is enforceable -- would start the accrual of such interest from the making of each loan. The monetary spread between the parties' positions therefore is huge; indeed, Brooklyn Lender's claims including its claims to default interest are more than double the amount that the Debtors assert.

The Bankruptcy Code and case law address claims to pre- and postpetition interest differently. One looks to applicable state law to determine the allowance of a creditor's claim for prepetition interest. *Key Bank National Association v. Milham* (*In re Milham*), 141 F.3d 420, 423 (2d Cir. 1998); *In re Residential Capital LLC*, 508 B.R. 851, 858 (Bankr. S.D.N.Y. 2014). Under New York law, which governs here, given the location of the mortgaged properties and the parties, will generally enforce unambiguous contract provisions for default interest at a higher rate than pre-default interest, even if the default interest is at a high rate and reflects a large spread against non-default interest. *Pereira v. Prompt Mortg. Providers of N. Am., LLC* (*In re Heavey*), 608 B.R. 341, 348-49 (Bankr. E.D.N.Y. 2019), and the

cases cited therein. In *Heavey*, as here, the lender's default rate was 24 percent, but the court nevertheless allowed the lender's claim for it. *See also In re Campbell*, 513 B.R. 846, 850 (Bankr. S.D.N.Y. 2014), *aff'd* 2015 U.S. Dist. LEXIS 129992 (S.D.N.Y. Sept. 28, 2015), also allowing a prepetition claim for 24 percent default interest.

A default under the parties' contract must of course have occurred for the default rate to be owed. *In re Northwest Airlines Corp.*, 2007 Bankr. LEXIS 3919 at *5 (Bankr. S.D.N.Y. Nov. 9, 2007). Moreover, as noted in *In re Heavey*, 608 B.R. at 349-50, and the cases cited therein, New York law recognizes certain limited circumstances in which a court may refrain from enforcing a loan contract when it comes to acceleration and the accrual of default rate interest. The Debtors have raised such a defense to Brooklyn Lender's claim to prepetition default interest, as well as contended that at least some of the defaults relied on by Brooklyn Lender were not, in fact, defaults at all.

Postpetition interest is governed by the Bankruptcy Code in addition to applicable non-bankruptcy law. First, section 502(b)(2) of the Bankruptcy Code disallows claims for "unmatured interest," i.e.

postpetition interest, although courts have recognized exceptions to that rule as applied to unsecured claims against chapter 11 debtors based on various theories, namely under (x) the "best interests" test in section 1129(a)(7) of the Bankruptcy Code, because under the distribution scheme in a case under chapter 7 of the Bankruptcy Code -- which Bankruptcy Code section 1129(a)(7) requires a creditor's treatment under a chapter 11 plan must at least equal -- creditors are entitled to payment of postpetition interest at the "legal rate" before distributions to the debtor's interest holders (*see* 11 U.S.C. § 726(a)(5)), or (y) the "fair and equitable" test of section 1129(b) of the Bankruptcy Code in a cram down, or (z) longstanding case law (*see, e.g.,* *Vanston Protective Bondholders Committee v. Green*, 329 U.S. 156, 162-65 (1946); *Ruskin v. Griffiths*, 269 F.2d 827, 831 (2d Cir. 1959)), holding that before any return to interest holders, creditors should receive postpetition interest at a rate to be determined by the Court applying equitable principles.

In addition, section 506(b) of the Bankruptcy Code provides that "to the extent that an allowed secured claim is secured by property, the value of which after any recovery under subsection (c) of this section [which

is irrelevant here] is greater than the amount of such claim, there shall be allowed to the holder of such claim interest on such claim and any reasonable fees, costs or charges provided for in the agreement or state statute under which such claim arose."

It is well established that section 506(b) does not require an oversecured creditor's postpetition interest to be paid at any *particular* rate, the issue here. Under section 506(b)'s plain meaning, the rate of postpetition interest is instead within the limited discretion of the court, *In re Milham*, 141 F.3d at 423, or, as stated in *In re 139-41 Owners Corp.*, 313 B.R. 364, 368 (S.D.N.Y. 2004), at the "sole" discretion of the court, which thus returns one to pre-Bankruptcy Code caselaw holding that "[i]t is manifest that the touchstone of each decision on allowance of interest in bankruptcy, receivership and reorganization has been a balance of the equities between creditor and creditor or between creditors and the debtor." *Vanston Bondholders Protective Committee v. Green*, 329 U.S. at 162.

There is a presumption, however -- and most cases describe it as a strong presumption -- that the "contract rate" will apply under section 506(b), subject to limited equitable considerations. Whether that

presumption in favor of the contract rate is for default interest of just pre-default contract interest is less clear. See generally *In re Heavey*, 608 B.R. at 353; *In re 1111 Myrtle Ave. Grp., LLC*, 598 B.R. 729, 736 (Bankr. S.D.N.Y. 2019); *In re General Growth Props., Inc.*, 451 B.R. 323, 326 (Bankr. S.D.N.Y. 2011).

As noted, the Plan provides for unimpairment of Brooklyn Lender's claims under section 1124(1) of the Bankruptcy Code. That section has been interpreted, including specifically by the Fifth Circuit on the issue of the allowance of a claim for postpetition interest, to be subject to the requirements of the Bankruptcy Code as they pertain to claim allowance. Namely, although section 1124(1) states that a claim is impaired unless the plan leaves unaltered the legal, equitable, and contractual rights to which such claim or interest entitles the holder of such claim or interest, Congress contemplated that those rights include the Bankruptcy Code's own limitations on claim allowance, including limitations on the allowance of postpetition interest. *See* *Keystone Gas Gathering L.L.C. v. Ad Hoc Comm.* (*In re Ultra Petroleum Corp.*), 943 F.3d 758, 763-65 (5th Cir. 2019), and the cases cited therein, including *Solow v. PPI Ents. (US)* (*In re PPI Enters.(US)*), 324 F.3d 197,

201-02 (3d Cir. 2003).

Having written legislative history to the amendment to section 1124, H.R. Rep. 103-835 at 47-48 (1994), that was intended to supersede a case that had provided for unimpairment of the claim of an unsecured creditor of a solvent debtor without paying postpetition interest to that claimant (*In re New Valley Corp.*, 168 B.R. 73 (Bankr. D. N.J. 1994), I was at first surprised by *Ultra Petroleum*'s holding, but, having considered its discussion of the legislative history generally and the operation of the statute, I agree with it. I therefore conclude that unimpairment under section 1124(1) does not eliminate the factors that courts consider when they decide whether to apply a contract interest rate under section 506(b) and, more specifically, the consideration of those factors when deciding whether to employ a default rate as opposed to a non-default contract rate.

Those factors are now fairly well established, and it also is generally recognized that, given the importance of predictability with respect to the treatment of secured loans in bankruptcy, they should be applied "sparingly" to diverge from the contract rate. *See In re Residential Capital*, 508 B.R. at 857. In addition to the state law factors limiting acceleration

and the enforcement of pre-bankruptcy default interest, which apply to postpetition interest, as well, courts consider the following under section 506(b): the solvency of the debtor's estate; whether the contract rate is considered a penalty; if there has been misconduct by the creditor; if allowing the creditor's claim to postpetition interest at the contract rate would harm other creditors; and, lastly, the adverse effect that allowing such interest would have on the debtor's fresh start. *In re Heavey*, 608 B.R. at 352; *In re 1111 Myrtle Ave. Grp.*, 598 B.R. at 736, and the cases cited therein.

None of these factors is dispositive; allowance is decided on a case-by-case basis. It is fair to say, however, that if the debtor is solvent and unsecured creditors will be paid in full even if the higher contract rate is allowed, courts will allow the claim at the default rate under section 506(b). *See, e.g.*, *In re 1111 Myrtle Ave. Grp.*, 598 B.R. at 738, 741 (confirmed plan, solvent debtor, unsecured creditors paid in full); *In re General Growth Props.*, 451 B.R. at 330, 331 (plan confirmed and effective, unsecured creditors paid in full, debtor was highly solvent). In such cases, the debtor's "fresh start" also was not jeopardized by

allowance at the higher default rate. *See also* *Urban Communicators PCS Ltd. P'ship v. Gabriel Capital, L.P.*, 394 B.R. 325, 338 (S.D.N.Y. 2008) (solvent debtor; debtor's "fresh start" not implicated because debtor was liquidating). Thus, the only issue was the allocation of value between the secured creditor on the one hand and the debtor's interest holders on the other, which *Ruskin v. Griffiths* long ago determined requires payment of the secured creditor at the higher default rate on equitable grounds. 229 F.2d at 831-32. *See also* *Official Comm. of Unsecured Creditors v. Dow Chem. Corp.* (*In re Dow Corning Corp.*), 456 F.3d 668, 680 (6th Cir. 2006), *cert. denied*, 127 S. Ct. 1874 (2007).

As for whether the default rate would be considered a "penalty," a significant spread between non-default and default interest has not been construed by several courts as a penalty justifying disallowance under section 506(b), just as it generally has not under applicable New York law. *See* *In re Heavey*, 608 B.R. at 354, and the cases cited therein, where a spread of, in those cases, 18.625 percent, 12 percent, and 8.8 percent between default and non-default rates was not viewed as a penalty for purposes of section 506(b). *See also* *In re Urban Communicators PCS Ltd. P'ship. v. Gabriel Capital*,

394 B.R. at 341-42, in which the court noted that a 24 percent default rate was enforceable under New York law and thus also should have been allowed against a solvent liquidating debtor for purposes of section 506(b).

On the other hand, other decisions have been less tolerant of a significant spread between non-default and default interest. *See* *Southland Corp v. Toronto-Dominion* (*In re Southland Corp.*), 160 F.3d 1054, 1060 (5th Cir. 1998) (affirming allowance of default interest under section 506(b) based on trial court's findings that other, junior creditors would remain "unscathed" by the bankruptcy and "[t]he 2% spread between default and pre-default interest rates is relatively small"); *see also* *In re La Guardia Assocs., L.P.*, 2006 Bankr. LEXIS 4735, at *113-15 (Bankr. E.D. Pa. Sept. 13, 2006) (default interest that was 33 percent higher than non-default rate supports allowance at non-default rate); *In re Manuel Mediavilla, Inc.*, 2016 Bankr. LEXIS 3469, at *6-9 (Bankr. D. P.R. Sept. 23, 20160 (postpetition interest allowed at 5% non-default rate instead of 8% default rate, which was viewed as "a coercive penalty that affects Debtors' possibilities of reorganization"), *rev'd on other grounds*, *PRLP 2011 Hldgs., LLC v. Manuel Mediavilla, Inc.*, 568 B.R. 551 (B.A.P. 1st Cir. 2017). *La Guardia*

and *Manuel Mediavilla* each reasoned that because the creditor bought the loan knowing it was in default and would have priced the default risk in the loan purchase agreement, allowing default interest would be inequitable. 2006 Bankr. LEXIS 3469, at *113-15; 2016 Bankr. LEXIS 4735, at *8. *See also* *In re Family Pharm., Inc.*, 605 B.R. 900, 912 (Bankr. W.D. Mo. 2019); *In re Vest Assocs.*, 217 B.R. 696, 703-04 (Bankr. S.D.N.Y. 1998); Fischer Enters. v. Geremia (*In re Kalian*), 178 B.R. 308, 314-17 (Bankr. D. R.I. 1995).

Although the spread here between non-default and default interest is significant, I would not view the parties' default rate, standing on its own, as an unenforceable penalty for purposes of section 506(b), largely for the reasons articulated in *In re Route One West Windsor Ltd. P'Ship.*, 225 B.R. 76, 87-90 (Bankr. D. N.J. 1998). I do not accept some courts' logic of finding a penalty based on an analysis of what would be a "reasonable profit" for a defaulted loan. To do so would unduly curtail the ability to sell defaulted loans, which might cause lenders to overprice pre-default interest and lead courts to reduce claims based on what the claimant paid for the loan, a proposition disavowed as early as Hamilton's First Report on the Public Credit.

Here, each of the Debtors is solvent, at least based on the Debtors' claims calculations. On the other hand, if Brooklyn Lender's claims are allowed in full, most, if not all, of the Debtors will become insolvent, the Debtors will be unable to confirm the Plan and, more importantly, unless they find additional, materially greater financing, which appears unlikely, most, if not all, of the Debtors would either have the automatic stay lifted as to their underlying properties or liquidate either in Chapter 11 or in converted cases under Chapter 7 of the Bankruptcy Code. If Brooklyn Lender's claimed default interest were allowed in full, therefore, it appears that some, if not all, of the Debtors would not receive a fresh start. In addition, based on the evidence before me in connection with the best interest analysis of the Plan under section 1129(a)(7) of the Bankruptcy Code, unsecured creditors of most, if not all, of the Debtors would not be paid in full. Such considerations applied in both *La Guardia* and *Manuel Mediavilla*, and indeed had a greater influence on those courts' decisions to allow postpetition interest at the non-default rate than their analyses of the default rate as a "penalty." 2006 Bankr. LEXIS 4735, at *115; 2016 Bankr. LEXIS 3469, at *8-9. *See also In re Family Pharm., Inc.* 605 B.R. at

913, and *In re Vest Assocs.*, 217 B.R. at 703-04 (each considering effect of default interest on other creditors). Few, if any, reported decisions have confronted such a mix of factors arguing both in favor of and against the allowance of default interest as exist here.

The final factor when deciding whether to allow postpetition interest under section 506(b) of the Bankruptcy Code at less than the default rate is creditor misconduct, over which the Debtors and Brooklyn Lender are in major disagreement.

It is worth noting at the outset that "lender misconduct" has been held not to include merely acquiring a loan with the intention of enforcing a default thereunder, which clearly was Brooklyn Lender's strategy here. *See* *Downtown Ath. Club of N.Y. City v. Caspi Dev. Corp.* (*In re Downtown Ath. Club of N.Y. City*), 1998 Bankr. LEXIS 1642, at *25-26, 31-33, 34-35 (Bankr. S.D.N.Y. Dec. 21, 1998). *See also* *In re 139-141 Owners Corp.*, 313 B.R. at 369. It is also worth noting that the Debtors have not asserted the affirmative defense of champerty under N.Y. Judiciary Law § 489 (McKinney 2020), perhaps because of the safe harbor contained in N.Y. Judiciary Law § 489(2). *Justinian Capital SPC v. WestLB*

AG, N.Y. Branch, 28 N.Y.3d 160, 167-70 (2016); *Phoenix Light SF Ltd. v. United States Bank NA*, 2020 U.S. Dist. LEXIS 46950, at *31-33 (S.D.N.Y. March 8, 2020).

Instead, the Debtors contend that Brooklyn Lender asserted several types of default that either were not in fact defaults or would not justify acceleration or be enforceable under applicable non-bankruptcy law. The Debtors further allege that because of these wrongfully asserted defaults, and Brooklyn Lender's continued pursuit of default interest tied to them, Brooklyn Lender unduly delayed the Debtors' exit from Chapter 11, which *is* recognized as "lender misconduct" for purposes of section 506(b). *See, e.g.*, *In re Nixon*, 404 Fed. App'x 575, 579 (3d Cir. 2010).

The allegedly wrongfully asserted defaults are as follows. First, in May 2017, Brooklyn Lender called a default based on section 18(g) of the loan agreements against several of the Debtors on the ground that either the borrower or its principal, Mr. Strulovitch provided a misleading certificate or other written misinformation regarding the borrower's ownership as part of the loan application or the making of the loans. In addition, Brooklyn Lender contends that several of the Debtors have violated the same section based on Mr. Strulovitch's

submission in connection with loan applications of a personal financial statement that grossly overstated his net worth. As noted, the parties agree that if Brooklyn Lender is correct, default interest would run from the commencement of each loan because such misrepresentations would give rise to a default at that time. The Debtors contend, however, that none of these defaults would be enforceable under New York law.

In addition, Brooklyn Lender has alleged that two of the Debtors, 618 Lafayette LLC and Eighteen Homes LLC, breached sections 9 and 18(q) of their loan agreements by permitting encumbrances on their respective property securing the loans, the encumbrance on 618 Lafayette LLC's property being a mortgage to a Mr. Schwimmer and the encumbrance on 18 Homes LLC's property being a restriction in favor of a Mr. Greenfeld on its sale or other transfer, each of which was publicly filed with the county clerk. The Debtors contend that because Messrs. Schwimmer and Greenfeld have disavowed the encumbrances as "mistakes" and have removed them from the land records, the defaults are not enforceable.

The Debtors also contend that although Brooklyn Lender has accurately alleged defaults under section 18(o) of the loan agreements based upon uncured New York

City Building Code violations on many, if not all, of the Debtors' properties, such defaults would not support acceleration and the enforcement of default interest under New York law.

Each loan agreement has a stated maturity date and provides in section 36 that until paid following maturity, default interest will accrue on the unpaid balance. Certain of the loans -- to D&W Real Estate Spring LLC, 1125-1133 Greene Ave. LLC, 325 Franklin LLC, 1213 Jefferson LLC, APC Holding 1 LLC, and 92 South 4th St. LLC -- have in fact matured, in each case postpetition. The Debtors contend, however, that Brooklyn Lender delayed payment of the loans on maturity by its misconduct in wrongfully asserting and prosecuting the other defaults, and, therefore, that the roughly $3.66 million of post-default interest accruing on the matured balances should not be allowed under section 506(b).

Finally, the Debtors contend that without other valid defaults it would be inequitable under section 506(b) to allow Brooklyn Lenders' claim for postpetition default interest merely because the Debtors filed their bankruptcy cases, which is listed as a default under section 18(i) of the loan agreements.

I will address each of these asserted defaults as to whether they actually exist, where that has been challenged by the Debtors, and then as to whether they are enforceable under New York law and, as to postpetition interest, whether Brooklyn Lender is not entitled to postpetition interest under section 506(b) of the Bankruptcy Code even if it is entitled to it under New York law

Let me begin with the defaults alleged to have occurred based on the mere commencement of the Debtors' bankruptcy cases.

Each Debtor has indisputably remained current on regularly scheduled non-default interest payments on the outstanding principal amount of each loan, before any acceleration or the loan's maturity. When the only default was the bankruptcy filing itself, courts have properly held, that post-default interests should not be allowed under section 506(b). *In re Residential Capital*, 508 B.R. at 862; *see also* *In re Bownetree, LLC*, 2009 Bankr. LEXIS 2295, at *11-14 (Bankr. E.D.N.Y. July 24, 2009); *In re Northwest Airlines Corp.*, 2007 Bankr. LEXIS 3919 at *16-18.

I disagree with *Bownetree*'s rationale that allowance at the default rate under such circumstances

would be tantamount to enforcing an ipso facto provision prohibited by section 365(e)(1) of the Bankruptcy Code, 2009 Bankr. LEXIS, at *8-9; section 365(e)(2)(B) excepts loan contracts from that provision. 11 U.S.C. § 365(e). Rather, as Judge Glenn found in *Residential Capital*, there is no basis to allow a claim for postpetition default interest if there is no doubt that the lender will be paid in full and, in fact, the lender has been paid currently under its agreement. In *Northwest Airlines*, Judge Gropper concluded that to the extent there was a default other than the bankruptcy filing, it was not a meaningful default and therefore allowance of default interest was not required, 2007 Bankr. LEXIS 3919, at *16-18; thus, the case's fundamental principle is similar to the holding in *Residential Capital*, namely that a mere bankruptcy default should not trigger default interest if it is clear that the debtor will be paying the non-default rate currently and ultimately will satisfy the claim under its chapter 11 plan. *See also In re Vest Assocs.*, 217 B.R. at 704. Analysis to the contrary in *In re 1111 Myrtle Ave. Grp.*, 598 B.R. at 738-39, is concededly dicta given the court's finding that the debtor had defaulted under a separate provision of the loan agreement in addition to the bankruptcy default.

Id. at 740. Thus, if the only default here was a Debtor's filing for relief under the Bankruptcy Code, Brooklyn Lender's claim for postpetition default interest would be disallowed.

Turning to the other asserted defaults New York law, as noted, places certain limitations on the ability of a creditor with a mortgage on real property to enforce, including by acceleration, certain types of defaults. New York law generally categorizes loan defaults either as (a) payment, or monetary defaults, i.e. the failure to pay principal or interest when due, or (b) non-monetary defaults, basically every other type of default. Absent truly extraordinary circumstances such as lender misconduct or a de minimis delay in making a payment, New York law will not limit a lender's right to accelerate and enforce a loan based on its borrower's monetary default. *See, e.g.*, *CIT Small Bus. Lending Corp. v. Crossways Holding, LLC*, 2014 N.Y. Misc. LEXIS 4175, at *6-7 (Sup. Ct. N.Y. Cty. Aug. 29, 2014); 1 Bergman on New York Mortgage Foreclosures, § 5.06 (2020).

New York has long recognized broader equitable exceptions to enforcing the parties' contract with respect to acceleration and non-monetary defaults, however. Generally, courts look to three factors: has

the lender suffered actual damages as a result of the default; has the default impaired the lender's security, that is, the collateral securing the debt; and does the default make the future payment of principal and interest less likely? Courts also consider whether the default was inadvertent or insignificant, although in analyzing whether the default was insignificant or, to the contrary, material, they usually apply the foregoing three factors. See the leading case of *Karas v. Wasserman*, 91 A.D.2d 812, 812-13 (3d Dep't. 1982), as well as such decisions as *Empire State Bldg. Assocs. v. Trump Empire State Partners*, 245 A.D.2d 225, 226-28 (1st Dep't. 1997); *Tunnell Pub. Co. v. Strauss Commun., Inc.*, 169 A.D.2d 1031, 1032 (3d Dep't. 1991); *Blomgren v. Tinton 763 Corp.*, 18 A.D.2d 979, 979-80 (1st Dep't. 1963); *100 Eighth Avenue Corp. v. Morgenstern*, 4 A.D.2d 754 (2d Dep't. 1957); and *Rockaway Park Series Corp. v. Hollis Automotive Corp.*, 206 Misc. 955, 957-58 (Sup. Ct. N.Y. Cty. 1954). *See also* Michael Giusto, "Note: Mortgage Foreclosure for Secondary Breaches: A Practitioner's Guide to Defining 'Security Impairment,'" 26 Cardozo L. Rev. 2563 (May 2005), which discusses not only this general rule, but also how courts determine whether a default actually impairs a lender's security or makes

future payment less likely or causes the lender actual harm.

Having evaluated each of the remaining defaults alleged by Brooklyn Lender in the light of that case law and the testimony and other evidence before me, it is clear that certain defaults called by Brooklyn Lender should not be enforced while others should be.

That testimony was by the following people: the Debtors’ principal, Mr. Chaskiel Strulovitch; the Debtors’ manager, Mr. Goldwasser, primarily as to the Plan’s feasibility; Mr. Kohn, with respect to how the Debtors have addressed New York City Building Code violations; Mr. Moses Strulovitch, Mr. Wagschal, and Mr. Hutman, whose testimony in addition to that of Mr. Chaskiel Strulovitch, was relevant to the alleged failure to accurately disclose the ownership interests in certain Debtors in connection with the loan applications; Mr. Halpern and Mr. Schonberg, with regard to the nature of the ownership interests and claims asserted by the Israeli Investors; Mr. Aviram, the representative of Brooklyn Lender, with regard to the actions it took with respect to the alleged defaults; Brooklyn Lender’s two experts, Ms. Stewart and Mr. Madison, who opined on the context of lenders’ evaluation of defaults, including

non-monetary defaults, and the importance of enforcing defaults; and, finally, Mr. Stagnari, the loan officer at Signature Bank responsible for administering the Debtors' loans before Brooklyn Lender purchased them at face, although he was not the loan officer when the loans were originated.

The foregoing New York law applies most clearly to block the acceleration and enforcement of default interest based on various New York City Building Code violation defaults. Mr. Stagnari's testimony on this issue was most telling. At all times, not just on this issue, Mr. Stagnari was not only unbiased, but also a very knowledgeable witness, his testimony reflecting considerable experience with loans of this type. He testified that he is in charge a large portfolio of commercial real estate loans at Signature Bank -- both in terms of the number of loans under his supervision and their dollar amount -- having worked his way up the chain of loan officer responsibility. He consistently appeared well informed and experienced regarding lending practices from the creditor's perspective with respect to commercial real estate loans like these in the New York area.

Brooklyn Lender's two expert witnesses, on the

other hand, provided little to no meaningful testimony on any of the default-related issues. Ms. Stewart proffered almost literally no testimony that was relevant to commercial real estate loans secured by rental properties in New York City. Her experience, albeit lengthy and of a responsible nature over a long career, has been with consumer loans on the consumer's own residential property, although sometimes property that had more than one or two units within it. It is clear from her own testimony that considerations about non-monetary defaults and a borrower's moral character in that context are materially if not entirely different than when addressing the commercial real estate loans at issue here. I therefore gave far more weight to Mr. Stagnari's testimony than Ms. Stewart's as to what a reasonable lender would do with respect to the non-monetary defaults asserted here.

For his part, Mr. Madison's testimony did not contradict the conclusions that I reach here. He simply noted the importance of a default rate for monetary defaults and testified in general terms that non-monetary defaults are important although courts have come up with exceptions to their enforcement.

Mr. Stagnari testified that to his knowledge

Signature Bank has *never* called a non-monetary default, and, accordingly, has never called a non-monetary default based on New York City Building Code violations. He was also clear that almost every, and perhaps every, building in his extensive New York City loan portfolio has Building Code violations on it.

Mr. Kohn was also clear that the Debtors have successfully addressed the violations and either cured and removed them of record, or reasonably believe because of that cure that they will remove them of record (albeit that the process of removing violations of record, consistent with such process generally in New York City, has taken considerable time). In the light of this and Mr. Stagnari's testimony, I find that such alleged defaults placed Brooklyn Lender at no risk with respect to payment or impairment of its collateral. Such violations therefore would not warrant Brooklyn Lender's acceleration of the loans or the enforcement of 24 percent default interest.

On the other hand, the encumbrances placed of record on the buildings owned by 618 Lafayette LLC and Eighteen Homes LLC not only violated sections 9 and 18(q) of those Debtors' loan agreements, but also serve as a valid basis for acceleration and the enforcement of

default interest under New York law. Such encumbrances impaired Brooklyn Lender's interest in the collateral, and I do not believe, contrary Mr. Cheskiel Stulovitch's testimony and the submissions by the non-Debtor parties to those encumbrances, Messrs. Schwimmer and Greenfeld, that those encumbrances were accidental or inadvertent. The actual encumbrances are memorialized in simple written agreements in each case signed by Mr. Strulovitch on behalf of the applicable Debtor. It is hard to imagine, therefore, that they were mere mistakes. They are not lengthy documents, they specifically refer to the properties at issue, and they clearly provide for the respective encumbrances.

It is true that Messrs. Schwimmer and Greenfeld have since waived their rights under their respective agreements and that the encumbrances are no longer of record. Thus, today Brooklyn Lender's security is not impaired by them. However, it *was* impaired from the date they were recorded until the date the waivers were filed on the county records, and therefore the defaults support acceleration and the accrual of default interest under New York law as against those two Debtors from the date of the defaults to the date of cure.

The Debtors contend that the next type of

default alleged by Brooklyn Lender -- that certain of the Debtors or Mr. Cheskiel Stulovitch misrepresented those Debtor's ownership in or in connection with a loan application -- not only should not serve as a basis for acceleration and the enforcement of default interest, but also never occurred. Brooklyn Lender asserts, to the contrary, that Mr. Strulovitch was listed in connection with the loan applications as owning 100 percent of the following Debtors' ownership interests when, in fact, 45 percent of those interests were owned by one or more of the Israeli Investors: 325 Franklin LLC, 1213 Jefferson LLC, 106 Kingston LLC, and 618 Lafayette LLC. In addition, Brooklyn Lender alleges that two other Debtors, Meserole and Lorimer LLC and D&W Real Estate Spring LLC, were not owned 99 percent by Mr. Strulovitch and 1 percent by Mr. Wagschal as represented, but, rather, entirely or almost entirely by Mr. Wagschal. Finally, Brooklyn Lender contends that the following Debtors were not 100 percent owned by Mr. Strulovich but, instead, only 50 percent by him -- APC Holding 1 LLC, Eighteen Homes LLC, 167 Hart LLC, 53 Stanhope LLC, 1125-1133 Greene Ave. LLC, 92 South 4th Street LLC, 834 Metropolitan Ave. LLC, and 55 Stanhope LLC -- and that the following Debtors were not owned 99 percent by Mr.

Strulovitch but, rather, 85 percent by him: 119 Rogers LLC and 127 Rogers LLC. For these latter two categories of asserted defaults, Brooklyn Lender alleges that a Mr. Gutman owns 50 percent of the following Debtors -- 834 Metropolitan Ave. LLC, 92 South 4th Street LLC, and 1125-1133 Greene Ave. LLC -- Mr. Greenfeld owns 50 percent of Eighteen Homes LLC, and limited liability companies at least affiliated with and perhaps 100 percent owned by Mr. Strulovitch or his family own the interests in the other Debtors that are not directly owned by Mr. Stuolovitch.

Perhaps because Brooklyn Lender's identification of these alleged defaults -- especially the first set based on its review of pre-bankruptcy litigation between the Israeli Investors and Mr. Stulovitch -- apparently inspired Brooklyn Lender to buy the loans in the first place in order to call the defaults, they have attracted most of the parties' attention.

The applicable Debtors contend that each of the disputed third-party ownership interests were not, in fact, ownership interests but, rather, "profit sharing interests." Each of the Debtors at issue is a limited liability company. Limited liability companies under the tax laws record income with respect to any such interest,

i.e. profit sharing interests, as an ownership interest or a partner interest on their tax returns because they report income and losses as a partnership and such an interest is a form of interest in the LLC, although the two interests are different as to the entitlement to capital in a liquidation. *See* Rev. Proc. 93-27, 1993-2 C.BB. 343 (1993); Bradley T. Borden, "Profits-Only Partnership Interests," 74 Brooklyn L.R. 1283, 1296-97 (2009). Accordingly, these Debtors issued K-1s that the record reflects identify the claimed ownership interests as alleged by Brooklyn Lender, with the exception of the four Debtors with regard to the 45 percent Israeli Investor interests, which do not appear on the K-1s associated with those Debtors.

As to those four Debtors, however, Brooklyn Lender introduced evidence that each had an operating agreement that did recognize or provided for 45 percent ownership interests to be held by Israeli Investors. Mr. Strulovitch testified that the parties nevertheless thereafter changed the nature of those interests to "profit sharing interests" because the Signature Bank loans would not have been made without such change. That is conceivable, but there is no separate record of it, and, more importantly, I do not accept Mr.Strulovitch's

testimony that Signature Bank knew about this change as reflected in a hearsay conversation he testified he had with the original loan officer, Mr. Dietz.

As a fallback, the Debtors contend that the Israeli Investors' interests in the four Debtors were at best profits sharing interests, too, and, in any event, are no more than a claim subject to subordination under section 510(b) of the Bankruptcy Code for the right to be issued ownership interests in the four Debtors, and, as to the Individual Israeli Investors, only an ownership interest in the four Israeli Investor LLCs that were to invest in them. Thus, the Debtors contend, there was no failure of disclosure in or in connection with the loan applications.

The only testimony of any Israeli Investors was vague as to the intended nature of their ownership interest in any Debtor, with the exception of their assertion that they or their family members were persuaded by a Mr. Oberlander to invest in certain unidentified single purpose limited liability companies -- the Israeli Investor LLCs – which in turn were to be managed by Mr. Oberlander and Mr. Strulovitch and would invest in single asset real estate companies controlled by Mr. Strulovitch. The Israeli Investor witnesses could

not identify, however, which companies were to be owned 45 percent by the Israeli Investor LLCs.

Both Mr. Strulovitch and Mr. Wagschal acknowledged that Mr. Wagschal had a greater interest in certain of the Debtors than was disclosed in or in connection with the loan applications for those Debtors. One can reasonably infer from Mr. Wagschal’s testimony that titular ownership of these Debtors was transferred in large measure by Mr. Wagschal to Mr. Strulovitch to shield them from Mr. Wagschal’s creditors, with the two men recognizing that Mr. Wagschal nevertheless would in effect be entitled to most or all of these Debtors’ value and would have the major say in their management.

Mr. Strulovitch, Mr. Wagschal, and Mr. Gutman had only the most rudimentary understanding of an ownership interest in an LLC or, for that matter, of what they viewed to be a lesser, profit sharing interest. Such testimony is hard to credit given the commercial experience of these men, but, taking into account the Jewish orthodox community in which they live and do business -- which they credibly testified relies more on trust among its members than legal documentation or characterization of ownership interests for tax purposes -- it is possible that their naivite is not feigned.

However, I conclude that the better view is that third parties -- namely Mr. Wagschal and Mr. Gutman and at least the Israeli Investor LLCs, if not the Individual Israeli Investors -- had ownership interests, broadly defined, in certain Debtors that were not disclosed when those Debtors or Mr. Strulovitch represented their ownership structure in or in connection with their loan applications. Brooklyn Lender also established that the ownership interests of Mr. Strulovich's affiliates and relatives also were not fully disclosed at that time.

On the other hand, in applying New York law that I previously summarized, I do not believe that this is the type of default that would serve as a basis for acceleration or enforcement of default interest. First, it is not clear that the loan applications sufficiently solicited disclosure of ownership interests as I have broadly defined the term above. More importantly, I do not see how Signature Bank's collateral or ability to be repaid was in any way affected by such failure to disclose, to the extent that it constituted a default.

Each of the loans was non-recourse to the Debtors' owners, including Mr. Strulovitch. Mr. Strulovitch only gave what Mr. Stagnari described as a "bad boy guarantee" to Signature Bank, not a monetary

guarantee, that would be triggered if Mr. Stolovitch caused the borrower to take certain prescribed actions. It also is clear from Mr. Stagnari’s testimony, as well as his and other Signature Bank officers’ analysis of the loans as reflected in the bank’s Credit Offering Memoranda, that Signature Bank relied upon the Debtors’ properties’ income stream, i.e. rental payments, and/or the value of the properties, themselves, to support a refinancing or a sale in order to repay the loans. Neither Signature Bank nor Brooklyn Lender undertook a meaningful credit analysis of Mr. Strulovitch or any other disclosed owner. It did not even request a balance sheet or other financial disclosure by the other actually identified owners besides Mr. Strulovitch that were disclosed to it. And even as to Mr. Strulovitch, Signature Bank did not, according to Mr. Stagnari’s testimony, pay attention to his credit reports. Signature Bank did require a relatively brief financial statement from him, but Brooklyn Lender’s representative, Mr. Aviram, found the dramatic increase in value of Mr. Strulovitch’s net worth on that financial statement to be incredible on its face and I conclude that Signature Bank also would have done so and would not have relied on it and in fact did not rely on it.

The only possible adverse effect that might have stemmed from the apparent failure to accurately disclose the owners, broadly speaking, of certain of the Debtors would be to subject the lender to a potential violation of money laundering and Patriot Act rules and regulations or "know your customer" rules. In post-argument briefing, the parties have addressed that issue. Although the regulatory regime is complex, and I believe clearly beyond the knowledge of Mr. Strulovitch, I conclude that such nondisclosure, even the failure to disclose a profits interest or other similar less than full ownership interest in a borrower, might put a lender at risk of such a violation. *See* 31 C.F.R. §§ 542.315, 1010; https://www.treasury.gov/resource-center/sanctions/Documents/licensing guidance.pdf. (each focusing on the need for analysis of direct and indirect ownership interests or control).

On the other hand, there is no evidence that Signature Bank conducted any such analysis as to the Debtors' disclosed owners. Moreover, such a risk had no bearing on it or Brooklyn Lender being paid in full or risk of impairment of the collateral. There is no evidence, either, that upon learning of potential undisclosed owners of certain of the Debtors, Brooklyn

Lender undertook any analysis or reporting to the applicable authorities. Indeed, Brooklyn Lender's constant refrain that the challenged interests were full ownership interests and not just more limited "profits interests" strongly suggests that the regulatory risk did not carry any weight with it, since mere profits interests would likely trigger a review and reporting requirement, too. Finally, there is no suggestion that any of the third-party owners would in fact be the types of investor targeted by the applicable rules and regulations.

I therefore conclude that under New York law the alleged defaults arising from the failure to accurately disclose certain of the Debtors' owners, broadly speaking, would not support acceleration or enforcement of a default rate. I also conclude that the obvious inaccuracies in Mr. Strulovitch's financial statements also would not justify acceleration or enforcement of default interest.

That leaves one other set of defaults. None of the loans matured by its terms before the bankruptcy filing date, but, as noted, several of them have since matured. There is no question that under New York law post-maturity default interest would be enforced upon the

applicable Debtor's failure to pay the matured loan except in extremely limited circumstances such as the lender's failure to honor a payment or other lender misconduct preventing payment. Courts considering the allowance of postpetition interest under section 506(b) also have held that default interest should be allowed after the loan's maturity date passed, barring some overriding equitable factor to the contrary. *In re Residential Capital*, 508 B.R. at 862; *see also* *In re Route One West Windsor Ltd. P'Ship.*, 225 B.R. at 78, 91.

The Debtors have argued that Brooklyn Lender's own misconduct prevented them from paying the loans at maturity, an argument deserving careful consideration given that I have held that many of the defaults called by Brooklyn Lender did not warrant acceleration and the imposition of default interest under longstanding New York law. (And such law goes back at least to the 1920s; there are not many recent cases, but one can reasonably attribute this to the law being well established as of at least the 1980s.)

The problem with the Debtors' argument is that the Debtors have not established that they had the ability to pay the matured loans until they obtained the Lightstone Capital exit facility commitment, and they

have not shown that Brooklyn Lender's conduct proximately caused such inability. It is clear, moreover, that even with the Lightstone Capital exit facility, the Debtors will not be able to confirm their Plan, because too many of the Debtors are in fact liable for post-default interest for the Plan to proceed under section 1124(1).

Brooklyn Lender also established that the Debtors did not even exercise their right to force an extension of the applicable loan' maturity dates, which under certain circumstances they have under the loan documents, until the Plan was filed, well after many of the loans had matured. There also was ample evidence that there were late payments on most of the matured loans, even if those payments did not rise to the level of a payment default, and, therefore, as to those loans it is clear that Brooklyn Lender could not be forced to grant a maturity extension under the loan agreements' extension provision.

At oral argument, counsel for Brooklyn Lender confirmed that the roughly $3.6 million of default interest tied to maturity defaults ran only from the maturity date to the confirmation hearing date. And while the Debtors' counsel said that she was not sure whether that analysis properly took into account any

payments that should have been applied to principal and were not, it appears that Brooklyn Lender is properly calculating the default interest from the maturity date of each loan as opposed to some earlier time.

This returns us to consideration of whether the equitable factors limiting the allowance of postpetition interest at the default rate under section 506(b) of the Bankruptcy Code should apply to Brooklyn Lender's claims to such interest based on the maturity defaults and "no encumbrance" defaults under certain Debtors' loans. As suggested above, this is a close question because while the applicable Debtors are solvent, allowance of such default interest will lead to denial of confirmation of the Plan, which may harm not only those Debtors' owners, but also other creditors besides Brooklyn Lender. For the same reason, those Debtors' fresh start would jeopardized by denial of the Plan's confirmation.

Because the Debtors are single asset real estate entities, however, their "fresh start" under the Plan would not entail the preservation of going concern value, a significant number of jobs, or supplier relationships. It would instead primarily preserve ownership of the properties in the current owners. In addition, a debtor's insolvency has never been a per se basis for

denying an oversecured creditor's claim to postpetition interest at the default rate. *In re Residential Capital*, 508 B.R. at 857-58. Lastly, the Israeli Investors have asserted the largest claims against the Debtors; most other creditors, besides Brooklyn Lender, appear to be insiders. And, albeit inexplicably to the Court (because it would appear that confirmation of the Plan is the Israeli Investors' best and perhaps only chance recover from the Debtors), the Israeli Investors oppose confirmation and have not sought to reduce Brooklyn Lender's claims.

Weighing all of these facts and equitable considerations, I conclude that the record does not support further reduction of Brooklyn Lender's claims to default interest accruing during the "encumbrance period" against 618 Lafayette LLC and Eighteen Homes LLC, nor its claims for post-maturity default interest against Debtors whose loans matured or will mature prior to the filing of a viable chapter 11 plan.

Turning to the Plan's treatment of the Israeli Investors, it important to note again that there are two sets of them: the Israeli Investor LLCs and the Individual Israeli Investors. Moreover, the Israeli Investor LLCs have asserted two different types of claims

against the Debtors. First, the Israeli Investor LLCs claim that they were thwarted by 3225 Franklin, 618 Jefferson, 106 Kingston and 1213 Lafayette and/or Mr. Strulovitch from investing in those Debtors' equity. It is easy to conclude that such claims are subordinated to the level of those ownership interests under the plain terms of section 510(b) of the Bankruptcy Code, as they are for damages arising from the attempted purchase of a security of one of such Debtors.

In addition, however, those same Israeli Investor LLCs, as well as other Israeli Investor LLCs and the Individual Israeli Investors, have filed proofs of claim against the other Debtors alleging that the other Debtors participated in a fraudulent scheme by Mr. Oberlander and Mr. Strulovitch to take the Israeli Investor LLCs' money intended to be invested in specific, though unidentified (with the exception of the four Debtors just mentioned), real estate projects, and instead divert that money for other uses. Unless, however, those claimed funds were intended to be invested in an affiliate of a Debtor (defined in section 101(2)(B) of the Bankruptcy Code as "a corporation [applied by the caselaw to include limited liability companies], 20 percent or more of whose outstanding voting securities

are directly or indirectly controlled, or held with power to vote, by . . . an entity that directly or indirectly owns, controls, or holds with power to vote, 20 percent or more of the outstanding voting securities of the debtor" other than in capacities that would not here apply, 11 U.S.C. § 101(2)(B)), such a claim would *not* be covered by section 510(b) of the Bankruptcy Code. See, for example, *In re Wash. Mut. Inc.*, 462 B.R. 137, 145-47 (Bankr. D. Del. 2011), and *In re Semcrude, L.P.*, 436 B.R. 317, 321 (Bankr. D. Del. 2010), each of which holds that section 510(b) applies only to claims based on the purchase or sale of securities of the debtor or the debtor's affiliate, not fraud by the debtor or an affiliate with respect to the purchase or sale of securities of a different, non-affiliate entity.

It is quite possible that the allegedly fraudulently transferred funds were diverted from being invested in an affiliate of a Debtor, as defined by section 101(2)(B), especially under the logic of *Templeton v. O'Cheskey (In re Am. House Found.)*, 785 F.3d 143, 155-57 (5th Cir. 2015), which reads "affiliate" more broadly than the two Delaware cases previously cited to include entities under the control of an affiliate. However, the Debtors have not made such a showing. There

is really no proof that the allegedly transferred funds or improperly transferred funds were intended to go to any specific "affiliates," including as defined in *Templeton*, with the exception of the four specific Debtors already identified. Thus, the Debtors have not made their case as to these claims' treatment under the Plan under section 510(b).

This is not the end of the inquiry regarding the other Israeli Investor claims, however. The main reason the Debtors were not able to make the foregoing showing is that there is nothing in the record other than wholly conclusory allegations to show that any such funds actually were meant to go to any specific entities or that Debtors participated in or received any wrongful diversion of funds. The testimony of the Israeli Investors specifically omitted any contention to the contrary. The proofs of claim, which attach the complaints in pre-bankruptcy litigation on this point, are extremely vague on the facts, and clearly do not satisfy Fed. R. Bankr. P. 7009, incorporating Fed. R. Civ. P. 9(b), as to the elements of fraud, including when these allegedly fraudulent diversions occurred, who the recipients were intended to be and in fact were, and the like. Thus, the Debtors' inability to subordinate most

of the Israeli Investors' claims does not on this record require denial of the Plan's confirmation; the Plan is feasible notwithstanding the Debtors' inability to pay the Israeli Investors' claims because those claims lack support.

The second group of Israeli Investors -- the Individual Israeli Investors -- have a second impediment to the allowance of their claims against all of the Debtors, as well. As conceded by the two Individual Israeli Investors who testified at the trial, these claimants did not invest in the Debtors, but, rather, in the Israeli Investor LLCs. They are at best, therefore, either creditors of or shareholders in the Israeli Investor LLCs and assert claims against the Debtors only derivatively through the Israeli Investor LLCs and are not even parties in interest. See *In re Terrestar Networks, Inc.*, 2013 Bankr. LEXIS, at *6 (Bankr. S.D.N.Y. Feb. 28, 2013). *See also In re Refco Inc.*, 505 F.3d 109, 118-19 (2d Cir. 2007), and *In re Comcoach Corp.*, 698 F.3d 571, 574 (2d Cir. 1993).

The Israeli Investors raised certain other objections to confirmation of the Plan: that the Plan provides for the substantive consolidation of the Debtors' estates, that the Plan violates the best

interests test of 11 U.S.C. § 1129(a)(7), and that the Israeli Investors' claims, to the extent not subordinated under 11 U.S.C. § 510(b), were in fact impaired and therefore entitled to vote to reject the Plan under section 1126 of the Bankruptcy Code, forcing a cram down. I believe that each of these objections was addressed in detail during oral argument, and I will incorporate those rulings into this Modified Decision.

In short, by its plain terms the Plan does not provide for substantive consolidation of the Debtors' estates. The only basis for the Israeli Investors' contention to the contrary was that the proposed exit loans were cross collateralized, but that does not equate with substantive consolidation, just as cross-collateralization of DIP loans under section 364 of the Bankruptcy Code, 11 U.S.C. 364, does not result in substantive consolidation. For the reasons detailed on the record of oral argument at Tr. pages, 35, 37, 38 and 41-42, the Plan in fact satisfies section 1129(a)(7) of the Bankruptcy Code with the exception of one Debtor, 106 Kingston, which the Debtors' counsel conceded would be separately carved out from the Lightstone Capital exit facility, at which point that Debtor also would satisfy section 1129(a)(7). Finally, the Debtors have a pending

objection to the Israeli Investors' claims, which the Israeli Investors have not sought to be temporarily allowed for voting purposes. Assuming, consistent with my ruling, that the Debtors are not able to subordinate all of the Israeli Investors' claims on this record under section 510(b) of the Bankruptcy Code, the Israeli Investors therefore nevertheless are not allowed to vote on the Plan as Class 4 (General Unsecured) Claims.

At oral argument I also denied the Israeli Investors' request for the appointment of a Chapter 11 trustee pursuant to section 1104 of the Bankruptcy Code, 11 U.S.C. § 1104. As noted then, there is no support for the appointment of a trustee on this record and, indeed, the Israeli Investors did not offer any evidence for such relief thus clearly did not carry their burden of proof.

I therefore direct the Debtors to prepare an order consistent with my rulings denying confirmation of the Plan for the reasons stated, namely that Brooklyn Lender's claims against certain of the Debtors for default interest based on the maturity of the loans to those Debtors as well as against two Debtors based on the encumbrances permitted by those Debtors would give rise to claims that could not be rendered unimpaired by full cash payment under the Plan.

I have not addressed Brooklyn Lender's claims for payment of its legal fees and expenses, for three reasons. First, I am sure that it has incurred more fees after those covered by the submitted time and expense records. Secondly, the Debtors should have the opportunity to review those time and expense records in the light of my ruling which, again, reflected that certain of the defaults called by Brooklyn Lender really would not be enforceable and, therefore, might reflect on the reasonableness of fees and expenses related to attempts to enforce those defaults. Finally, such review is best taken in a clear context where there is a practical prospect of recovering such fees and expenses, whereas at this time it is unclear whether that context will ever come to pass.

It is conceivable that some or even all of the Debtors (albeit most likely only on a consensual basis) may still be able to confirm a plan or plans in the future. In any event, I direct counsel for the Debtors to schedule a case conference for within the next 30 to 45 days to address the next steps in these cases, which also could serve as a hearing date if a party in interest wants to seek relief, for example in the form of a motion for relief from the automatic stay under section 362 of

the Bankruptcy Code, conversion of one or more of these cases to a case under Chapter 7 of the Bankruptcy Code, or the filing of its own Chapter 11 plan.

Dated: White Plains, New York
February 18, 2021

/s/Robert D. Drain
United States Bankruptcy Judge